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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Some Implications of Iraq's Oil Nationalization

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
June 1972

INTELLIGENCE MEMORANDUM

SOME IMPLICATIONS OF IRAQ'S OIL NATIONALIZATION

Introduction

1. In a sudden and dramatic move on 1 June 1972, the Iraqi government nationalized all the assets of the Iraq Petroleum Company (IPC), a consortium of US, British, Dutch, and French oil firms operating in northern Iraq. The nationalization culminates 11 years of smoldering disputes between the members of the oil consortium and the Iraqi government. The same group of oil firms also controls the only two other non-government oil-producing companies in Iraq -- the Mosul Petroleum Company (MPC) and the Basrah Petroleum Company (BPC). These companies, which have less production than the IPC, have not been affected by the nationalization decree. In concert with the Iraqi move, the Syrian government seized the Syrian portion of the IPC pipeline through which the oil produced in northern Iraq is transported to ports on the eastern Mediterranean. This memorandum describes the events leading up to the nationalization and analyzes Iraq's ability to maintain output and sales of the newly acquired oil. In addition, the possible repercussions on the Iraqi economy and the world oil market resulting from the action are discussed.

Discussion

Background

2. The source of the present conflict between Iraq and IPC is rooted in "Law 80" promulgated in 1961. From 1925 until 1961, IPC held concessions in Iraq covering virtually the entire country. This law withdrew from IPC all concession acreage not then being worked by IPC companies -- an area amounting to more than 99% of the total. The canceled concessions

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included the potentially prolific North Rumaila oilfield that IPC had discovered and partly developed, but from which production had not yet begun. The companies refused to acknowledge the validity of the law, and for more than a decade the dispute simmered. Intermittent government-company discussions failed to resolve the issue. In retaliation, IPC refused to grant Iraq the same financial benefits that other members of the Organization of Petroleum Exporting Countries (OPEC)* were able to obtain in the mid-1960s, such as expensing royalties. This action has led to an Iraqi claim for back payments of nearly $400 million. Negotiations on the back payments claims and the North Rumaila issue took place again in January and February 1972 but ended in deadlock primarily because of IPC's adamant stand on compensation for the loss of the North Rumaila oilfield.

3. Tensions between IPC and the government were accentuated when oil production from the northern oilfields dropped sharply during March, April, and early May 1972. The Iraqis regarded this cutback as a further attempt to apply retaliatory pressure against the government following the breakdown of negotiations in February. By mid-May as the Revolutionary Command Council (RCC) saw the serious downturn in government oil receipts, which are vitally needed for political as well as economic reasons, IPC was threatened with confiscatory legislation if the company did not increase production from the northern oilfields, agree on a long-term production program, and make a "positive offer" on the other outstanding issues. On 31 May, IPC agreed to increase production from the northern oilfields and to set up a long-range production program but continued to demand compensation for the loss of North Rumaila. By then the RCC had already decided on the need for a dramatic political move, and Oil Minister Hamadi rejected the proposal out-of-hand, insisting that Iraq would never pay compensation for the North Rumaila field. The nationalization law was adopted the next day.

4. IPC has six shareholders: British Petroleum (BP), Shell Petroleum, and Compagnie Francaise des Petroles (CFP), each with 23.75%; the two American oil companies, Mobil and Standard Oil (New Jersey), are equal partners in the Near East Development Corporation and jointly own another 23.75%; and the C.S. Gulbenkian Estate owns the remaining 5%. The company's production comes mainly from the Kirkuk oilfield in northern Iraq and is exported via pipeline across Syria to the eastern Mediterranean ports of Banias in Syria and Tripoli in Lebanon.

* The member states of OPEC are: Iran, Iraq, Kuwait, Saudi Arabia, Abu Dhabi, Qatar, Algeria, Libya, Indonesia, Venezuela, and Nigeria.

Prospects for Iraq's Producing and Marketing the Oil

5. Although production has apparently now been stopped on orders from Baghdad, output could begin on short notice. Maintaining output from the nationalized facilities and transporting the oil from the Kirkuk field to the Mediterranean ports should pose no insurmountable problems for the Iraqis. The operation of the northern fields is already almost entirely in the hands of Iraqi nationals who are expected to remain under the new ownership. The Syrians similarly should encounter little difficulty operating the IPC pipeline.

6. Production is not the problem, however. The most serious problem facing the Iraqis is finding buyers. The companies comprising IPC control a large share of the world oil market. It is unlikely that they would agree to market the nationalized oil without an Iraqi commitment for prompt and adequate compensation. Moreover, the companies will undoubtedly take steps to discourage any other Western oil company from taking the oil. Legal action by the French firms, CFP and Entreprise des Recherches et d'Activities Petrolieres (ERAP), in their nationalization dispute with Algeria in 1971 and by British Petroleum after it had been nationalized in Libya proved successful in preventing Algeria and Libya from marketing much of their nationalized oil. The Basrah Petroleum Company, which still claims the North Rumaila oilfield, also has threatened legal action against any consignee of that oil, and as a result Iraq has met with only limited success in marketing the small production from the North Rumaila field.

7. Iraq's offer to give special consideration to CFP is clearly an effort to solve the marketing problems. CFP is short of crude oil and could make good use of the additional supply. However, CFP, which is 35% French government owned, undoubtedly will be subjected to intense political pressures from the other countries involved. CFP probably will seek at least the tacit approval of its partners in IPC before entering negotiation with Iraq.

8. The Iraqis apparently have already turned to the USSR for assistance in marketing the oil. An Iraqi delegation headed by Foreign Minister Qadduri and including the Director of Oil Affairs left for Moscow on 2 June, the day after the nationalization occurred. Whether the Soviet Union will be able to offer Iraq much assistance is doubtful. The USSR is already heavily involved in operating the North Rumaila oilfield, which began producing in April, and is taking a small amount of Rumaila oil in repayment for its assistance. The USSR might be reluctant or unable to divert or charter enough tanker capacity to handle more than a fraction of Iraq's northern oil production. Moreover, the USSR probably could not

market a large amount of the oil either domestically or in Eastern Europe especially in the short-term. For its part the USSR is already a substantial petroleum exporter. Soviet exports last year were some 2 million barrels per day (bpd) of which about 60% went to other Communist countries. Moscow is not likely to use Iraqi oil to displace its own sales particularly in the West where oil is the USSR's single largest foreign exchange earner. The Soviets may, however, make some modest purchases of Iraqi oil. East European imports from the West are quite modest – less than 200,000 bpd, most of which comes from Iran and Egypt. Neither of these sources is likely to be displaced by Iraqi oil.

Effect on World Oil Supply

9. IPC production from the northern oilfields in 1971 averaged about 1.1 million bpd – about 2% of world oil production. Production by BPC from the southern Iraq oilfields was about 600,000 bpd in 1971. MPC has very small production from two fields in the northwest. The IPC companies, with the exception of CFP and Gulbenkian, should have only short-term dislocation problems in making up the nationalized production. BP, Shell, Esso, and Mobil are all thoroughly integrated international companies with a diversified source of crude oil. The production lost in Iraq can probably be offset by increased output elsewhere in a relatively short time. However, CFP obtains the largest share of its crude oil supplies from Iraq, and this will probably make CFP more disposed to working out a marketing arrangement with Iraq. The Gulbenkian share is normally sold through brokers.

10. The Iraqis chose a poor time to nationalize IPC. The growth in oil demand in the main oil consuming centers has been sluggish the last 18 months because of slow economic growth in the United States, Western Europe, and Japan, unusually high stocks in Western Europe, and abnormally mild weather in many parts of the world. Many oil-producing countries – notably Venezuela, Libya, and Iraq itself – produced considerably below capacity during the first quarter of 1972. At the same time, other oil producing countries – notably Saudi Arabia and Iran – are implementing plans to increase capacity greatly. Moreover, the tanker shortage that existed two years ago prompted a widespread tanker building program with the result that the tanker market now suffers from substantial excess capacity. During the last two years, tanker capacity increased by about 30%, while worldwide petroleum consumption increased by only about 17%. The abundant supply of tanker capacity seriously weakens Iraq's bargaining position vis-a-vis potential oil consumers. It is therefore likely that the 1.1 million bpd from northern Iraq – actually about 650,000 bpd in recent months – can be made up through an increase in long-haul voyages from the Persian Gulf without serious disruption to the tanker market, although some firming in short-term tanker rates is inevitable.

Effect on Iraq

11. Iraq is heavily dependent on its share of IPC earnings which alone account for some 40% of government revenues. Total government oil revenues from IPC, MPC, and BPC in 1972 were projected at roughly $1 billion, of which between $600 million and $700 million came from IPC oil production in the north. Total imports of goods and services run about $900 million a year, and Iraq's foreign exchange earnings from sources other than IPC oil are about $500 million – $300 million from MPC and BPC. Thus the shortfall in import capacity if exports of IPC oil cease entirely will be about $400 million a year, or 45% of total imports of goods and services. Iraq has about $650 million in foreign exchange reserves -- some $200 million more than two years ago – which would cover the maximum shortfall for 18 months.

12. Every effort, however, probably will be made by the government to conserve its reserves. Baghdad already has taken austerity measures to slow their decline. Import controls have been stiffened. Public sector projects in the development program have been suspended for fiscal year 1972/73 (beginning 1 April) with the exception of those projects under way. The Central Bank has severely limited issuance of foreign exchange permits. These measures will temporarily halt Iraq's new and ambitious development program, which was showing some progress, and probably stop all economic growth. The situation would be eased, however, should Iraq get financial support from some Arab countries as expected. Soviet assistance is not likely to take the form of foreign exchange. Actually, Iraq has been paying for Soviet arms in hard currency.

Impact on Syria

13. Syria's enthusiasm for Iraq's nationalizing IPC and its own takeover of the IPC pipeline in its territory may wane if the dispute is a protracted one. Unless the oil is marketed, Damascus stands to lose about $82 million annually in transit and port dues that would have accumulated on Iraq oil flowing through the Syrian portion of the IPC pipeline. IPC dues accounted for about 14% of Syria's budget revenues in 1970 and were expected to provide about 17% of revenues in the 1972 budget which is deeply in deficit. Loss of these revenues also would be felt in Syria's balance of payments where they provided about 15% of the earnings on current account in 1970.

Effect on Other Oil-Producing Countries

14. Iraq's nationalization of IPC will present deep problems for the individual members of the Organization of Petroleum Exporting Countries (OPEC) of which Iraq is a member. In recent months, OPEC members have

worked toward achieving a degree of participation in the management of the oil companies operating within their boundaries. After long negotiations, the oil companies finally acceded to the principle of participation. The specific method of implementing the 20% participation is now being worked out but with very little progress reported so far. The Iraq nationalization further complicates the issue of participation and threatens to disassemble the hitherto united front put up by OPEC.

15. In order for Iraq to exert maximum pressure on IPC to come to a relatively speedy agreement, Baghdad will need the cooperation of other OPEC countries. Specifically, the Iraqis want these countries to prevent increases in their output that would offset the decrease in Iraq's production. Although OPEC has announced approval of the action taken by Iraq, it is doubtful that there will be agreement to control production. Libya and Algeria appear to be about the most willing to help the Iraqis.

16. It is highly unlikely that Saudi Arabia and Iran, the two countries who can most easily make up for any reduction in Iraq output, will be willing to hold back on output. Output in those two countries has been growing rapidly in recent years. It would be impossible to distinguish the part of the increased production that would have occurred normally from the part that is designed to offset Iraqi output.

Conclusions

17. The Iraqi government has nationalized the major part of its oil industry at a time when its negotiating position is extremely weak. Oil demand currently is growing at a rate far below that of the two last decades, tanker rates are near all-time lows, several countries are producing well below capacity, and others are striving mightily to substantially increase productive capacity. Production in the newly nationalized field was considered less profitable by the oil producers than oil that could be produced in the Persian Gulf, given recent market factors.

18. Producing and transporting the nationalized oil should pose no serious problems for Iraq. However, the oil companies comprising IPC will seek to prevent the nationalized oil from reaching Western markets. Markets in the Communist countries, on the other hand, can absorb only a small fraction of the approximately 1 million bpd of Iraqi oil normally exported from IPC fields. Conditions in the world oil market are currently such that the oil companies could deprive Iraq of a market for its oil by increasing output in other oil-producing countries. To prevent this from happening, the cooperation of most of the members of OPEC would be necessary.

It is unlikely that such cooperation will be forthcoming, particularly in the form of a restriction on output. Therefore, Iraq likely will suffer a substantial reduction in oil revenues for some time. The other members of OPEC, particularly Libya and probably Kuwait and some small Persian Gulf producers, will likely provide financial support if Iraqi oil cannot be sold. But even on its own, Iraq could stand a shutdown of its northern fields for years in view of its substantial foreign exchange reserves, though at the cost of a slowdown in economic growth.